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Federal Scholarship Tax Credit: Proposed Federal Regulations (October 2026) Summary and Implications for Colorado School Districts

Please note, the regulations are still proposed, so the final rules may change. The proposed rules do not establish if Colorado will participate or how the state would administer the program.

EXECUTIVE SUMMARY

The U.S. Department of the Treasury and the Internal Revenue Service (IRS) have released proposed regulations implementing the Federal Scholarship Tax Credit, established under Section 25F of the Internal Revenue Code through the One Big Beautiful Bill Act of 2025.

Beginning in 2027, the law will allow individuals to claim a federal income tax credit of up to \$1,700 annually for cash contributions to qualifying scholarship-granting organizations (SGOs). These organizations will use the contributions to provide scholarships for eligible K–12 students.

The proposed rules create a federal tax incentive for individuals to fund private and other eligible K–12 education expenses through Scholarship Granting Organizations (SGOs).

The proposed regulations raise several important issues involving student eligibility, school funding, scholarship administration, state oversight and the relationship between scholarship programs and public education. A few outstanding questions are addressed in the proposed rules, such as:

- States won't be allowed to block certain types of SGOs from accepting tax credit-eligible donations or dictate to whom SGOs direct funds.
- States will not be able to impose antidiscrimination and academic accountability requirements on SGOs and the schools and organizations that accept scholarship money.
- SGOs can operate in multiple states although students can only receive scholarships if their state is participating. Taxpayers in any state can receive the tax credits the program offers. If their governor hasn't opted in, they would have to donate to an SGO that serves students in a participating state.
- The proposed rules appear to allow states to opt-in or opt-out annually by January 1st of each year.

As of October 1, 2026, [31 states](#) have opted into the program. Legislation is pending in Congress to modify and repeal the program.

Bottom Line - This new federal tax incentive that could influence how families access K–12 education and how private contributions are directed toward scholarships. The immediate priority for district leaders is understanding the eligibility and accountability framework, monitoring Colorado's participation decision, and preparing for possible implications for enrollment, student services and local education planning.



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The proposed regulations do not, by themselves, establish a direct change to district funding. Nor do not establish a direct federal scholarship program administered by school districts or require districts to participate.

KEY PROVISIONS

Proposed requirements and limits under section 25F:

- Maximum individual tax credit: \$1,700 per taxpayer, per year
- Married couples filing jointly: \$3,400 potential combined credit
- Student income eligibility: 300% of adjusted area median income
- SGO scholarship spending: 90% of applicable income

Federal tax credit for individual contributions

- Individuals who are U.S. citizens or residents can receive a nonrefundable federal tax credit for qualifying cash contributions to approved SGOs.
- The annual credit is capped at \$1,700 per individual. Married couples filing jointly may claim up to \$3,400 if each spouse makes qualifying contributions.
- Any state tax credit received for the same contribution reduces the federal credit, but the proposed calculation applies the state credit reduction before the \$1,700 federal cap.
- Unused credits may be carried forward for up to five years, subject to applicable tax liability limitations.
- Contributions claimed for the federal credit cannot also be claimed as charitable deductions for those same amounts.
- The credit is available beginning with tax years ending after December 31, 2026.

Student eligibility and scholarship recipients

- Students must meet the statutory eligibility requirements, including:
 - Eligible to enroll in an elementary or secondary school.
 - Belonging to a household with income no greater than 300% of area median gross income, adjusted for household size.
 - Meeting the applicable state residency requirements.
- The proposed regulations provide several methods for SGOs to verify household income, including streamlined eligibility options.
 - These include households receiving certain public assistance benefits, such as SNAP, TANF, WIC, Section 8 housing assistance or Supplemental Security Income. Free and Reduced-Price Lunch Program is also allowed but requires individual FRLP forms in order to count. The proposed rules also include specific exceptions for certain students receiving tutoring or special needs services at qualifying schools in low-income areas and students placed in foster care.



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- Importantly, eligibility to receive a scholarship does not require a student to be attending a public school. Students who meet the requirements may receive scholarships for eligible expenses associated with other qualifying schools.

Eligible educational expenses

- Scholarship funds may be used for qualified elementary and secondary education expenses as defined by federal law. The proposed regulations require SGOs to verify that scholarship funds are used only for eligible expenses.
- The regulations allow several payment methods:
 - Direct payment to schools for tuition, fees, room and board, and similar expenses.
 - Direct payment to approved vendors for eligible services or items.
 - Reimbursement to families when receipts and other required verification are provided.
 - Qualified digital wallets that track expenses and control payments.
 - The Treasury Department indicates that additional guidance on the precise definition of qualified educational expenses will be issued separately.

Requirements for scholarship-granting organizations

To qualify, an SGO must be a tax-exempt public charity and meet several operational and accountability requirements:

- Student reach: Serve at least 10 students who do not all attend the same school.
- Scholarship spending: Spend at least 90% of applicable income on scholarships.
- Student priority: Prioritize returning scholarship recipients, followed by eligible students with siblings who received scholarships.
- Financial separation: Maintain separate accounts for federal scholarship contributions.
- Student eligibility: Verify income, family size and state residency, subject to approved exceptions.
- Expense verification: Ensure scholarships pay only for qualified educational expenses.
- Conflicts of interest: Prohibit scholarships to disqualified persons.
- Accountability: Submit annual certifications, maintain records and comply with audit requirements.

The proposed regulations also include an 85% scholarship-activity safe harbor for qualifying single-state SGOs. Such organizations may apply certain operational requirements to their federal scholarship accounts rather than their entire organization.

Multistate SGOs must maintain separate accounts for each participating state and meet applicable requirements separately for each account.

State participation and oversight

States may voluntarily elect to participate in the federal program. Our understanding is that a state can choose to opt out on an annual basis and that election needs to be made by January



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1st of the following year. The governor or another authorized state official must submit the state's SGO list to the IRS.

Under the proposed rules:

- States must verify that listed organizations meet the federal requirements.
- Organizations that meet the requirements and seek inclusion must be included on the state's list.
- States cannot impose additional, more restrictive SGO eligibility requirements than those established under the federal rules.
- States must establish procedures for monitoring compliance and notifying the IRS when an organization is removed from the list.
- This is particularly relevant to Colorado because state participation would determine which Colorado-based SGOs could receive contributions eligible for the federal credit.
- The proposed regulations do not establish a specific Colorado administrative structure or identify which state agency would oversee participation.

Potential Implications for Colorado School Districts

The proposed regulations do not impose direct operational requirements on public school districts. However, they create several issues that districts may want to monitor.

1. Potential changes in student enrollment

Students may use scholarships to attend eligible schools or pay for other qualifying educational expenses. Depending on how the program develops, districts may see changes in enrollment, particularly if scholarship funds support students who leave public schools.

2. Competition for educational funding

The federal tax credit creates a new mechanism for directing private contributions to scholarship organizations. The potential impact on public school resources will depend on participation, the amount of contributions, how scholarships are awarded and whether students change schools. The regulations do not establish a direct reduction in school district funding.

3. Potential opportunities for student services

The proposed rules specifically allow scholarships for certain tutoring and special needs services. Schools in qualifying low-income areas may also be involved in identifying students for certain scholarships under an income-verification safe harbor. This could create opportunities for eligible students to access additional services, although the rules do not require districts to provide or administer them. However, this approach could come with a significant administrative burden.

5. State oversight and local control



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Colorado's decision about whether to participate will be important. However, the proposed regulations limit the state's ability to impose additional requirements on SGOs or exclude organizations that meet the federal criteria. This could raise questions about the extent of state oversight and how Colorado's education priorities interact with the federal program.

6. Accountability and financial oversight

The proposed regulations place significant responsibility on SGOs to demonstrate that scholarship funds are used appropriately.

Key requirements include:

- Annual financial and programmatic audits.
- Annual certifications of compliance.
- Reporting on scholarship applicants, recipients, participating schools, award amounts and categories of expenses.
- Procedures to prevent duplicate payments for the same expense.
- Verification of student eligibility and scholarship expenditures.

The proposed rules require independent third-party audits for SGOs with annual receipts above \$500,000. Smaller organizations may use a committee of independent individuals unrelated to management.

The IRS estimates that the annual audit costs could range from \$10,000 to \$30,000 per SGO. These are costs borne by the scholarship organizations, not school districts.

OUTSTANDING QUESTIONS

The proposed regulations leave several issues that may warrant further discussion and clarification, including:

- If Colorado elects to participate, which state agency would oversee the program?
- How will districts monitor potential enrollment changes associated with scholarship participation?
- Could changes in enrollment affect district budgets and staffing?
- How might scholarship-funded tutoring and special needs services interact with existing district programs?
- Can we get clarification around what type of after-school programs are eligible?
- SGOs can provide students with scholarship funds they can spend on approved education expenses but the law is silent on the size of scholarship awards.
- How will Colorado monitor scholarship organizations and address concerns about the use of funds?
- What authority will districts retain over their own educational programs and services if students receive scholarships?
- What happens if Governor Polis opts-in Colorado to the program but does not submit a list of SGOs by February 15, 2027? Similarly, could the next Governor withdraw the list



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of SGOs after being formally sworn in and what would that mean for the state's participation in the program? If no SGO list is provided by February 15, 2027, is Colorado still opted into the program?

- How will the next Governor approach the program if Colorado is unable to opt out until January 1, 2028?

NEXT STEPS

Timeline

- Written comments are due 60 days after the publication date of October 2, 2026 which is December 1, 2026.
- The IRS has scheduled a public hearing at 10 a.m. EST on December 15, 2026. Individuals wishing to testify must submit a request and an outline of their topics by the comment deadline.
- For 2027, states must submit their state election by January 1, 2027 and submit their SGO list by February 15, 2027.
- The program begins for the 2027 tax year. The federal credit applies to taxable years ending after December 31, 2026.

Submit public comment

Comments can be submitted to the IRS through [Regulations.gov](https://www.regulations.gov) using docket number REG-117199-25. The IRS is specifically seeking feedback on the proposed requirements, including whether less burdensome alternatives could adequately prevent fraud and improper payments.